

**FINANCE OFFICE OF THE
DIOCESE OF CLEVELAND**

FINANCIAL REPORT

JUNE 30, 2011 and 2010

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND
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Most Reverend Richard G. Lennon
Roman Catholic Bishop of The Diocese of Cleveland
Cleveland, Ohio

Independent Auditors' Report

We have audited the accompanying statements of financial position of the Finance Office of The Diocese of Cleveland ("Finance Office") as of June 30, 2011 and 2010, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Finance Office's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Finance Office's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Finance Office as of June 30, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Maloney + Novotny LLC

Cleveland, Ohio
October 24, 2011

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

STATEMENT OF FINANCIAL POSITION

June 30, 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
ASSETS				
Cash and cash equivalents	\$ 4,915,685			\$ 4,915,685
Accounts receivable	2,962,231			2,962,231
Parish consolidation receivables, net of allowance for doubtful accounts of \$1,565,820	1,583,377			1,583,377
Parish and school notes receivable, net of allowance for doubtful accounts of \$1,328,000	204,541			204,541
Notes receivable	384,981			384,981
Land held for future parish sites	285,075			285,075
Assets held as custodian	29,449,869			29,449,869
Endowment investments	<u>2,286,633</u>	<u>\$ 11,762,570</u>	<u>\$ 47,759,109</u>	<u>61,808,312</u>
Total assets	<u>\$42,072,392</u>	<u>\$ 11,762,570</u>	<u>\$ 47,759,109</u>	<u>\$ 101,594,071</u>
LIABILITIES AND NET ASSETS				
Liabilities:				
Accounts payable	\$ 240,532			\$ 240,532
Accrued expenses and other liabilities	152,885			152,885
Funds held for others	<u>29,449,869</u>			<u>29,449,869</u>
Total liabilities	29,843,286			29,843,286
Net assets:				
Unrestricted	12,229,106			12,229,106
Temporarily restricted		\$ 11,762,570		11,762,570
Permanently restricted			<u>\$ 47,759,109</u>	<u>47,759,109</u>
Total net assets	<u>12,229,106</u>	<u>11,762,570</u>	<u>47,759,109</u>	<u>71,750,785</u>
Total liabilities and net assets	<u>\$42,072,392</u>	<u>\$ 11,762,570</u>	<u>\$ 47,759,109</u>	<u>\$ 101,594,071</u>

The accompanying notes are an integral part of these financial statements.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

STATEMENT OF FINANCIAL POSITION

June 30, 2010

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
ASSETS				
Cash and cash equivalents	\$ 6,051,746			\$ 6,051,746
Accounts receivable	936,907			936,907
Parish consolidation receivables, net of allowance for doubtful accounts of \$559,813	1,616,556			1,616,556
Parish and school notes receivable, net of allowance for doubtful accounts of \$550,000	689,125			689,125
Notes receivable	1,384,981			1,384,981
Land held for future parish sites	285,075			285,075
Assets held as custodian	23,661,494			23,661,494
Endowment investments	<u>2,352,868</u>	<u>\$ 11,639,982</u>	<u>\$ 43,251,700</u>	<u>57,244,550</u>
Total assets	<u>\$ 36,978,752</u>	<u>\$ 11,639,982</u>	<u>\$ 43,251,700</u>	<u>\$ 91,870,434</u>
LIABILITIES AND NET ASSETS				
Liabilities:				
Accounts payable	\$ 430,223			\$ 430,223
Accrued expenses and other liabilities	157,180			157,180
Funds held for others	<u>23,661,494</u>			<u>23,661,494</u>
Total liabilities	24,248,897			24,248,897
Net assets:				
Unrestricted	12,729,855			12,729,855
Temporarily restricted		\$ 11,639,982		11,639,982
Permanently restricted			\$ 43,251,700	43,251,700
Total net assets	<u>12,729,855</u>	<u>11,639,982</u>	<u>43,251,700</u>	<u>67,621,537</u>
Total liabilities and net assets	<u>\$ 36,978,752</u>	<u>\$ 11,639,982</u>	<u>\$ 43,251,700</u>	<u>\$ 91,870,434</u>

The accompanying notes are an integral part of these financial statements.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

STATEMENT OF ACTIVITIES

Year Ended June 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Assessments	\$ 13,588,650			\$ 13,588,650
Endowment and other contributions		\$ 73,499	\$ 84,781	158,280
Endowment and other investment income	1,423,059	262,760		1,685,819
Net realized and unrealized gains on investments	8,401	851,743	4,422,628	5,282,772
Rental income	357,276			357,276
Other revenues	411,719			411,719
Net assets released from restrictions	1,065,414	(1,065,414)		-
Total revenues	16,854,519	122,588	4,507,409	21,484,516
OPERATING EXPENDITURES				
Subsidies by Secretariat on Cathedral Square:				
Chancery	1,599,630			1,599,630
Clergy and religious	1,155,306			1,155,306
Education	2,712,457			2,712,457
Catechetical services	875,429			875,429
Finance	1,171,183			1,171,183
Legal	446,716			446,716
Parish life	1,029,924			1,029,924
Bishop's direct reporting offices	3,772,871			3,772,871
Catholic Community Foundation	778,614			778,614
Other expenses:				
Administrative	1,088,701			1,088,701
Pastoral	612,467			612,467
Real estate taxes	31,079			31,079
Distributions	736,316			736,316
Total operating expenditures	16,010,693	-	-	16,010,693
Change in net assets from operations before other changes	843,826	122,588	4,507,409	5,473,823
OTHER CHANGES				
Diocesan consolidation costs	(1,344,575)			(1,344,575)
CHANGE IN NET ASSETS	(500,749)	122,588	4,507,409	4,129,248
NET ASSETS AT BEGINNING OF YEAR	12,729,855	11,639,982	43,251,700	67,621,537
NET ASSETS AT END OF YEAR	\$ 12,229,106	\$ 11,762,570	\$ 47,759,109	\$ 71,750,785

The accompanying notes are an integral part of these financial statements.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

STATEMENT OF ACTIVITIES

Year Ended June 30, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Assessments	\$ 13,934,074			\$ 13,934,074
Endowment and other contributions		\$ 199,405	\$ 19,976	219,381
Endowment and other investment income	1,690,803	216,656		1,907,459
Net realized and unrealized gains on investments	5,659	400,721	3,369,164	3,775,544
Rental income	358,356			358,356
Other revenues	116,242			116,242
Net assets released from restrictions	712,492	(712,492)		-
Total revenues	16,817,626	104,290	3,389,140	20,311,056
OPERATING EXPENDITURES				
Subsidies by Secretariat on Cathedral Square:				
Chancery	1,605,801			1,605,801
Clergy and religious	1,139,584			1,139,584
Education	1,685,574			1,685,574
Catechetical services	860,321			860,321
Finance	1,144,482			1,144,482
Legal	520,698			520,698
Parish life	1,020,161			1,020,161
Bishop's direct reporting offices	3,747,899			3,747,899
Catholic Community Foundation	670,000			670,000
Other expenses:				
Administrative	1,428,910			1,428,910
Pastoral	620,352			620,352
Real estate taxes	28,565			28,565
Distributions	690,170			690,170
Total operating expenditures	15,162,517	-	-	15,162,517
Change in net assets from operations before other changes	1,655,109	104,290	3,389,140	5,148,539
OTHER CHANGES				
Diocesan consolidation costs	(762,593)			(762,593)
Special (distribution) contribution	(2,985,386)	2,985,386		-
Total other changes	(3,747,979)	2,985,386	-	(762,593)
CHANGE IN NET ASSETS	(2,092,870)	3,089,676	3,389,140	4,385,946
NET ASSETS AT BEGINNING OF YEAR	14,822,725	8,550,306	39,862,560	63,235,591
NET ASSETS AT END OF YEAR	\$ 12,729,855	\$ 11,639,982	\$ 43,251,700	\$ 67,621,537

The accompanying notes are an integral part of these financial statements.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 4,129,248	\$ 4,385,946
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Net realized and unrealized (gains on) investments	(5,282,772)	(3,775,544)
Contributions restricted for long-term investment	(84,781)	(19,976)
Changes in operating assets and liabilities:		
Increase in accounts receivable	(2,025,324)	(248,390)
Decrease (increase) in parish consolidation receivables	33,179	(838,018)
(Decrease) increase in accounts payable	(189,691)	124,377
Decrease in accrued expenses and other liabilities	<u>(4,295)</u>	<u>(4,286)</u>
Net cash used in operating activities	(3,424,436)	(375,891)
CASH FLOWS FROM INVESTING ACTIVITIES		
Decrease in investments, net	719,010	255,982
Proceeds from notes receivable	1,000,000	-
Proceeds from parish and school notes receivable, net	<u>484,584</u>	<u>86,502</u>
Net cash provided by investing activities	2,203,594	342,484
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions restricted for long-term investment	<u>84,781</u>	<u>19,976</u>
DECREASE IN CASH AND EQUIVALENTS	(1,136,061)	(13,431)
CASH AND EQUIVALENTS AT BEGINNING OF YEAR	<u>6,051,746</u>	<u>6,065,177</u>
CASH AND EQUIVALENTS AT END OF YEAR	<u>\$ 4,915,685</u>	<u>\$ 6,051,746</u>

The accompanying notes are an integral part of these financial statements.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS

Note 1. Organization and Operations

The Finance Office of The Diocese of Cleveland ("Finance Office") is organized under the stewardship of the Bishop of The Diocese of Cleveland (the "Bishop") and is responsible for the collection of assessments and Diocesan revenue, the payment of Diocesan obligations, the purchase and sale of land held for future parish sites, and all financial, real estate, and investment transactions that have been delegated to the Finance Office by the Bishop.

The major efforts of the Finance Office, which are reflected in the financial statements, relate to the funding requirements in the fields of education and religious development, community and human development, work for the universal church, support for high schools, grade schools, and inner city parishes, subsidies to religious and social programs, financing for parishes, as well as Diocesan administration and auxiliary services. In addition to these activities, the Finance Office makes loans to various parishes and other religious organizations.

These financial statements exclude certain activities of the Diocese such as parishes, schools, cemeteries, seminaries, charities, Catholic Community Foundation, etc. Each of these activities is an operating entity distinct from the Finance Office. These entities carry out and record their own services and programs.

Note 2. Summary of Significant Accounting Policies

Accrual Basis:

The accompanying financial statements have been prepared on the accrual basis of accounting and, accordingly, reflect all significant receivables, payables, and other liabilities.

Basis of Presentation:

The Finance Office financial statements are presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The Finance Office is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted.

A description of these categories follows:

Unrestricted Net Assets – Includes the net assets that are free of donor-imposed restrictions and are neither permanently restricted nor temporarily restricted.

Temporarily Restricted Net Assets – Includes the net assets from contributions or other inflows where the use is limited by donor-imposed restrictions that either expire by the passage of time or can be fulfilled and removed by the actions of the Finance Office.

Permanently Restricted Net Assets – Includes the net assets from contributions or other inflows where the use is limited by donor-imposed restrictions that neither expire by the passage of time nor can be fulfilled or removed by actions of the Finance Office.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 2. Summary of Significant Accounting Policies (Continued)

Contributions:

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction.

When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statements of Activities as Net Assets Released From Restrictions.

Revenues:

The principal source of operating revenue for the Finance Office is parish assessments. The amount levied against each parish is determined by applying a specific formula to parish revenues as defined by the Diocese. Assessments from parishes and other related entities are recorded as revenues when received. All other revenues are recorded on an accrual basis.

Cash and Equivalents:

The Finance Office considers all highly liquid investments, with initial maturities of three months or less, to be cash equivalents. These investments are carried at market value.

Investments:

GAAP requires that investments in equity securities with readily determinable fair values and all investments in debt securities be reported at fair value with realized and unrealized gains and losses included in a Statement of Activities. Investment income has been recognized in the Statements of Activities in accordance with the terms of any endowment restrictions.

Investments in U.S. Government obligations, corporate bonds, and mortgage backed securities, traded on a national securities exchange, are valued at the last reported sales price on the last business day of the fiscal year; investments traded on a national securities exchange for which no sale was reported on that date and investments traded on the over-the-counter market are valued at the last reported bid prices; and investments not having an established market are valued at fair value based upon the advice of the investment advisor.

Accounts Receivable:

Accounts receivable represent advances to churches, schools, and charitable and benevolent institutions associated with, or controlled by, the Diocese, as well as monies advanced to the Catholic Community Foundation.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 2. Summary of Significant Accounting Policies (Continued)

Parish Consolidation Receivables:

Parish consolidation receivables represent amounts expended to fund operating and maintenance costs for closed parishes that are held for current or future sale. The Finance Office provides for uncollectible parish consolidated receivables using the specific identification method. Management estimates an allowance of \$1,565,820 and \$559,813 as of June 30, 2011 and 2010, respectively. The estimate is based on management's review of parish consolidation receivables and an assessment of the Finance Office's historical evidence of collections and evaluation of the parishes' financial condition. Bad debt expense, net of recoveries, for the years ended June 30, 2011 and 2010 totaled \$1,006,007 and \$295,898, respectively, and is recorded in Diocesan consolidation costs.

Land Held for Future Parish Sites:

The Finance Office holds sites designated for future development. These sites are carried at cost or, in the case of property acquired by gift or from an estate, at appraisal value at date of acquisition until either formally committed for parish, cemetery, or other religious purpose, or sold if subsequent population projections later indicate the need as no longer probable. Until such date, taxes are paid on all such properties. Income property acquired from estates and dormant church facilities is disposed of as soon as practical.

Concentration of Credit Risk:

Financial instruments which potentially subject the Finance Office to concentration of credit risk consist principally of temporary cash investments, receivables, and marketable securities. The Finance Office places its temporary cash and other investments with national financial institutions and securities dealers, which may exceed federally and privately insured amounts at times. Cash accounts with financial institutions are insured by the Federal Deposit Insurance Corporation up to federally insured limits.

Use of Estimates:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Risk and Uncertainties:

The Finance Office maintains investments in U.S. Government obligations, corporate bonds, and mortgage backed securities. These investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the Statements of Financial Position.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 2. Summary of Significant Accounting Policies (Continued)

Fair Value of Financial Instruments:

The Financial Accounting Standards Board established a framework for measuring fair value and expands disclosures about fair value measurements by establishing a fair value hierarchy that prioritizes the inputs and defines valuation techniques used to measure fair value. The hierarchy gives highest priority to Level 1 inputs and lowest priority to Level 3 inputs. The three levels of the fair value hierarchy are described below:

Level 1 – Uses unadjusted quoted prices that are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Uses inputs other than Level 1 that are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets or liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data.

Level 3 – Uses inputs that are unobservable and are supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models and market assumptions.

The methods described below may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. Furthermore, while the Finance Office believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables set forth by level within the fair value hierarchy the Finance Office's financial assets and liabilities that were accounted for at a fair value on a recurring basis as of June 30, 2011 and 2010. The financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Finance Office's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and their placement within the fair value hierarchy levels. The tables do not include cash on hand or other assets and liabilities that are measured at historical cost or any basis other than fair value; for these items, their carrying value estimates fair value.

<u>June 30, 2011</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets				
Assets held as custodian	\$ 6,989,041	\$ 19,687,698	\$ 2,773,130	\$ 29,449,869
Endowment investments	143,347	59,683,822	1,981,143	61,808,312

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 2. Summary of Significant Accounting Policies (Continued)

Fair Value of Financial Instruments (Continued):

<u>June 30, 2010</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets				
Assets held as custodian	\$ 3,859,126	\$ 18,574,352	\$ 1,228,016	\$ 23,661,494
Endowment investments	134,366	55,129,041	1,981,143	57,244,550

Investments:

The Finance Office invests in cash and equivalents, equities, fixed income securities, and other securities with quoted prices in active markets that are considered to be Level 1 inputs. Level 2 inputs consist primarily of collective pooled investments and certificates of deposit, further detailed in Note 3. The fair values of investments in the collective pooled investments are valued based on their reported Net Asset Value ("NAV"). The NAV of short-term securities is based on the market value of their underlying investments, adjusted for charges and expenses, and is classified as Level 2 of the fair value hierarchy. Level 3 inputs consist primarily of land held as investments (endowment investments) and notes receivable (assets held as custodian). The land held for investment is based on a historical valuation of the land. The note receivable is generally based upon data that includes the amount due from a buyer in a seller financing agreement between a Diocesan organization and an outside party.

The following tables summarize changes of the Finance Office's Level 3 inputs:

	<u>Assets Held as Custodian</u>	<u>Endowment Investments</u>
<u>June 30, 2011</u>		
Beginning balance	\$ 1,228,016	\$ 1,981,143
Additions	1,590,750	-
Payments	(45,636)	-
Ending balance	<u>\$ 2,773,130</u>	<u>\$ 1,981,143</u>

	<u>Assets Held as Custodian</u>	<u>Endowment Investments</u>
<u>June 30, 2010</u>		
Beginning balance	\$ 1,115,019	\$ 1,981,143
Additions	118,997	-
Payments	(6,000)	-
Ending balance	<u>\$ 1,228,016</u>	<u>\$ 1,981,143</u>

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 2. Summary of Significant Accounting Policies (Continued)

Subsequent Events:

The Finance Office has evaluated all events subsequent to the Statement of Financial Position of June 30, 2011, through October 24, 2011, which is the date these financial statements were available to be issued.

Reclassifications:

Certain reclassifications have been made to the 2010 information to conform to the 2011 presentation.

Note 3. Investments

At June 30, 2011 and 2010, the following is the composition of investments:

Assets held as custodian:

	2011		2010	
	Cost	Market	Cost	Market
Cash and money market	\$ 6,284,735	\$ 6,284,735	\$ 2,511,517	\$ 2,511,517
Investments	704,306	704,306	1,347,609	1,347,609
Certificates of deposit	6,618,276	6,618,276	6,955,071	6,955,071
Collective pooled investments	12,410,612	13,069,422	11,812,130	11,619,281
Notes receivable	2,773,130	2,773,130	1,228,016	1,228,016
	<u>\$ 28,791,059</u>	<u>\$ 29,449,869</u>	<u>\$ 23,854,343</u>	<u>\$ 23,661,494</u>

Custodial assets and liabilities include funds held by the Finance Office for endowment or long-term investments on behalf of other Diocesan organizations, as well as assets from closed parishes which are held pending distribution. The notes receivable represent parish receivables related to financing that were granted to buyers of closed parish assets that are being held and serviced by the Finance Office on behalf of the parishes.

At June 30, 2011, the total of \$29,449,869 in assets held as custodian includes \$14,419,704 in assets directly related to parishes that were closed or merged pending distribution (see Note 9 for further discussion).

Endowment investments:

	2011		2010	
	Cost	Market	Cost	Market
Investments	\$ 152,538	\$ 143,344	\$ 156,562	\$ 134,366
Certificates of deposit	1,000,000	1,000,000	1,000,000	1,000,000
Collective pooled investments	54,430,817	58,683,825	53,559,201	54,129,041
Land held as investments	1,981,143	1,981,143	1,981,143	1,981,143
	<u>\$ 57,564,498</u>	<u>\$ 61,808,312</u>	<u>\$ 56,696,906</u>	<u>\$ 57,244,550</u>

The collective pooled investments are comprised of approximately 60% fixed income and 40% equity at June 30, 2011 and 70% fixed income and 30% equity at June 30, 2010.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 4. Notes Receivable

The Finance Office will occasionally sell Diocesan properties. In some cases, seller financing is accepted. Details of notes receivable at June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Note receivable from Hospice of the Western Reserve, Inc. paid in full December 2010.	\$ -	\$ 1,000,000
Note receivable from Hemingway at Richmond LLC payable in quarterly installments of interest only at 5.0% through November 2010, 6% through April 2012, with principal due at maturity in April 2012.	<u>384,981</u>	<u>384,981</u>
	<u>\$ 384,981</u>	<u>\$ 1,384,981</u>

Additionally, assets held as custodian include notes receivable at June 30, 2011 and 2010 of \$2,773,130 and \$1,228,016, respectively.

Note 5. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets consist primarily of the following funds which are distributed at the discretion of the Bishop. As of July 1, 2010, it was determined that the Communications Funds shown below should be included as part of the Finance Office's temporarily restricted net assets and, therefore, are included for both the years ended June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Bishop's Fund	\$ 7,319,560	\$ 7,267,812
Infirm and Senior Priests Funds	2,743,745	2,765,315
Seminary Fund	1,095,410	938,075
Communications Funds	<u>603,855</u>	<u>668,780</u>
	<u>\$ 11,762,570</u>	<u>\$ 11,639,982</u>

Permanently restricted net assets are invested and the income is available for distributions for the following purposes at June 30:

	<u>2011</u>	<u>2010</u>
Priestly formation	\$ 39,340,129	\$ 35,709,731
Education of priests	3,130,337	2,839,198
Other	<u>5,288,643</u>	<u>4,702,771</u>
	<u>\$ 47,759,109</u>	<u>\$ 43,251,700</u>

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 6. Lease Revenues

The Diocese leases certain land to an unrelated party under a lease agreement until 2055. Minimum annual rentals of \$348,000 are due until July 31, 2012, at which time they will be recalculated in accordance with the terms of the lease agreement. At the termination of the lease, any land improvements and buildings will transfer to the Diocese.

Note 7. Employee Benefits

Employees of the Finance Office are covered by the Group Life, Pension, Unemployment, Workers' Compensation, and Healthcare plans of The Diocese of Cleveland. The expense recorded related to these items was \$117,503 for the year ended June 30, 2011 and \$113,419 for the year ended June 30, 2010.

Note 8. Income Taxes

The Diocese is a tax-exempt organization under provisions of Section 501(c)(3) of the Internal Revenue Code and similar provisions of the State Code. Therefore, no provision for income taxes has been made.

Note 9. Parish Consolidation

During the past few years, the Diocese underwent a reconfiguration that resulted in the closure or merging of several parishes. In addition, four other parishes were closed or merged prior to the parish consolidation process under similar terms and circumstances. During that process, the Finance Office has acted as the custodian for some or all of the assets and liabilities of certain parishes, and has facilitated the payment of various costs incurred with closing the parishes and maintaining the facilities while they are held for sale or other disposition.

In cases where parishes were merged, the assets and liabilities of the joining entities were immediately and directly transferred to the newly-formed parish. The ongoing operating expenses related to the closed facilities transferred to the merged parishes are generally paid by the newly-formed parish with assistance from the Diocese, as needed.

For parishes that were closed, the Diocese has taken responsibility for the care and maintenance of the facilities pending their sale or other disposition. During this period, the assets of each parish were held in custody to cover maintenance and closing costs and to settle outstanding debts. Where parish assets were insufficient, the Diocese has paid for the ongoing operating expenses of these parishes. Following final property disposition, any remaining funds are distributed to parishes, or held for future distribution to parishes, as discussed later in this note.

Any closing, operating, or disposition costs following parish closure that are paid from Diocesan accounts are reimbursed from the closed parish assets where available, generally from sales proceeds after the facilities have been sold. The amounts are reflected in parish consolidation receivables until the reimbursement occurs. Expenses in excess of available parish assets, as well as consolidation costs not directly attributable to a specific parish, are borne by the Diocese and expensed as Diocesan Consolidation costs. The reserve for uncollectible amounts recorded against the parish consolidation receivables balance, totaling \$1,565,820 and \$559,813 at June 30, 2011 and 2010, respectively, represents management's estimate of the costs incurred at certain closed parishes that may not be recoverable from the available assets of the parishes. The reserves were recorded as a charge to Diocesan Consolidation costs at the time they were established.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 9. Parish Consolidation (Continued)

Following the closure of the parishes, the related properties were generally held for sale, except for fourteen closed parishes where the former parishioners have appealed the closure decision to the Vatican. To date, no formal ruling on the appeals has occurred and the parish assets are being held pending a final outcome. Formal third party appraisals were obtained and estimates of value were provided by professional real estate experts on the remaining closed parishes. Based on these indications of value, the Diocese held the remaining properties for sale. Actual sale transactions have occurred and the ultimate sales prices and terms were based on arms-length negotiations and buyer and seller due diligence procedures. Through September 30, 2011, the Diocese has sold twenty-seven of the closed parish properties, and is under contract to sell an additional three properties.

The following is a summary of critical cash flows that have occurred cumulatively through June 30, 2011 in the Finance Office related to the closed parishes:

Cash balances transferred from closed parishes, held by the Diocese pending disbursement	\$ 9,910,800
Proceeds from the sale of closed parish properties, net of transaction costs and repayment of mortgages	7,429,238
Cash receipts from incidental operations at closed parish properties, sales of closed parish religious items, and collections on notes receivable related to sales of property	<u>1,684,336</u>
Total cash received in the Finance Office	19,024,374
Repayment of closed parish obligations to the Diocese	(240,870)
Payment of operating expenses incurred while closed properties were held for sale (totaling \$6,509,879), net of expenses paid by the Diocese totaling \$3,149,197	(3,360,682)
Payment of past due pension, medical, insurance premiums, and retired priest healthcare	(400,141)
Closed parish contributions to charitable organizations	(330,000)
Cash disbursed to parishes	<u>(3,046,107)</u>
Cash held by Diocese as custodian for parishes, as of June 30, 2011	11,646,574
Parish notes receivable related to sales of property, held by Diocese as custodian, as of June 30, 2011	<u>2,773,130</u>
Total included on the balance sheet in Assets Held as Custodian and Funds Held for Others, related specifically to parish consolidation activity, as of June 30, 2011	<u>\$ 14,419,704</u>
Closed parish liabilities for unpaid insurance and benefits premiums and other Diocesan obligations as of June 30, 2011	<u>\$ 723,036</u>
Closed parishes' unpaid past due assessments to Diocese	<u>\$ 5,935,517</u>

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 9. Parish Consolidation (Continued)

The closed parishes have several unpaid obligations. These obligations represent unpaid premiums for the Diocesan pension, medical, and insurance programs, as well as costs associated with retiree priest healthcare that are the responsibility of the parishes. The remaining liability at June 30, 2011 for these obligations collectively totals \$723,036, and the receivable is recognized on the balance sheet of the entity to which the money is owed (not the Finance Office). Also, each parish has an obligation to pay an assessment each year to the Diocese in support of the Church ministry carried out through the Diocese, the United States Catholic Conference of Bishops, and the Vatican. At June 30, 2011, the cumulative unpaid assessments of the closed parishes total \$6,247,460. While assessments are accounted for on the accrual basis by the parishes, they are recognized on the cash basis by the Finance Office. Thus, the unpaid assessments are not recorded in the Finance Office financial statements.

Since the beginning of this consolidation process, cash held by the Diocese related to parishes that were closed or merged has been and will continue to be distributed in accordance with Canon Law. Accordingly, the monies were first applied to cover operating expenses and retire debts related to unpaid premiums, retiree priest healthcare, and loans/advances. Several parishes also requested that charitable contributions be made on their behalf to individual organizations and those requests were granted. The remaining monies were then primarily forwarded to parishes where large numbers of former parishioners subsequently registered.

In some cases, tracking of the parishioners was either impractical or not possible. In those cases, the monies have been placed into a restricted account where they will be used solely for the benefit of Diocesan parishes suffering from financial hardship or encountering a significant unexpected need that is beyond its financial means. Canon Law requires that the unpaid liabilities of closed parishes be distributed in the same manner as the assets when parishes are closed or merged. In most cases, the only remaining liabilities that existed after cash was distributed were unpaid assessments. While there are cash assets available to settle many of the closed parish assessment liabilities, the primary purpose of the parish reconfiguration project was to strengthen the works of the Church in the Diocese of Cleveland. With that in mind, the Finance Office is generally distributing both the assets and assessment liabilities from the closed parishes and will pursue repayment of the assessments in the future on a managed basis when the individual parishes can financially support repayment. In most cases, the parishes receiving the cash distributions are utilizing the money to complete significant repair/maintenance projects, establishing capital project funds to support future needs, or retiring parish loans and obligations.

As noted in the table above, \$3,046,107 was distributed to parishes during the fiscal year ended June 30, 2011. Subsequent to June 30, 2011, and through September 30, 2011, additional retirements of debt, payment of expenses, and distribution of cash have occurred as follows:

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 9. Parish Consolidation (Continued)

Repayment of closed parish obligations to the Diocese	\$ 375,292
Payment of operating expenses incurred while closed properties were held for sale	150,052
Payment of past due pension, medical, and insurance premiums and retired priest healthcare	420,695
Cash disbursed to parishes	3,030,231
Distribution of cash to a restricted account for the benefit of Diocesan parishes experiencing financial hardship (Parish Assistance Fund)	1,304,613

Note 10. Endowment Funds

Ohio has adopted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), which became effective June 1, 2009.

The Financial Accounting Standards Board provides guidance on the net asset classification of donor-restricted endowment funds, which requires enhanced disclosure for endowment funds. These disclosures are presented in the following paragraphs.

The Finance Office places great importance on risk reduction through diversification by asset class and management style. Investment results are measured using a five year period or a market cycle. Shorter time periods may be used to determine the trend of out performance or deficiencies.

The basic investment performance objective for the portfolio is to obtain a total return, net of all investment related fees, over a five year moving average that exceeds the total return of the respective index or benchmark for each asset class in the portfolio. In addition, each manager's performance must be at or above the median of their peer universe.

The investment strategy for asset allocation is 40% equity and 60% fixed income investments. The policy does not establish goals beyond this basic asset allocation but it recognizes that a variety of management styles would be employed within these two broad segments.

Market value fluctuations may cause variations from the basic strategic asset allocation policy. Rebalancing of the portfolio is done on a periodic basis generally when the asset allocation percentages vary from the policy percentages by 5% or more. The Finance Office does not deem it acceptable to time the market with tactical allocation shifts. The intention of this policy is to avoid short-term judgments that introduce significant unplanned risk.

The investment policy mandates moral and social investment responsibility consistent with the Socially Responsible Investment Guidelines of the United States Conference of Catholic Bishops.

Distributions from endowment funds are spent in compliance with the donor's restrictions applicable to the funds being distributed. Annual distributions from endowment funds are most generally limited to endowment interest and dividends, which are generally recognized as unrestricted endowment assets.

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

Note 10. Endowment Funds (Continued)

Endowment assets for the years ended June 30, 2011 and 2010 were as follows:

	2011			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment assets, beginning of year	\$ 2,352,868	\$ 11,639,982	\$ 43,251,700	\$ 57,244,550
Investment return:				
Endowment and other investment income	1,341,012	262,760	-	1,603,772
Net appreciation (realized and unrealized)	8,401	851,743	4,422,628	5,282,772
Total investment return	1,349,413	1,114,503	4,422,628	6,886,544
Endowment and other contributions	-	73,499	84,781	158,280
Appropriations of endowment assets for expenditure	(1,415,648)	(1,065,414)	-	(2,481,062)
Endowment assets, end of year	<u>\$ 2,286,633</u>	<u>\$ 11,762,570</u>	<u>\$ 47,759,109</u>	<u>\$ 61,808,312</u>

	2010			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment assets, beginning of year	\$ 5,312,122	\$ 8,550,306	\$ 39,862,560	\$ 53,724,988
Investment return:				
Endowment and other investment income	1,532,102	216,656	-	1,748,758
Net appreciation (realized and unrealized)	5,659	400,721	3,369,164	3,775,544
Total investment return	1,537,761	617,377	3,369,164	5,524,302
Endowment and other contributions	-	3,184,791	19,976	3,204,767
Appropriations of endowment assets for expenditure	(4,497,015)	(712,492)	-	(5,209,507)
Endowment assets, end of year	<u>\$ 2,352,868</u>	<u>\$ 11,639,982</u>	<u>\$ 43,251,700</u>	<u>\$ 57,244,550</u>

Note 11. Special Distribution/Contribution

In June 2010, unrestricted funds of the Finance Office were distributed through a \$2,985,386 special contribution to the Infirm Priests Fund, as directed by the Bishop.

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Most Reverend Richard G. Lennon
Roman Catholic Bishop of The Diocese of Cleveland
Cleveland, Ohio

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying information on pages 20 to 23 for the years ended June 30, 2011 and 2010, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Cleveland, Ohio
October 24, 2011

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

DETAIL OF UNRESTRICTED REVENUES AND SUBSIDIES BY
SECRETARIAT ON CATHEDRAL SQUARE

Years Ended June 30, 2011 and 2010

	2011 Budget	2011	2010 Budget	2010
Revenues:				
Assessments	\$ 13,400,000	\$ 13,588,650	\$ 12,750,000	\$ 13,934,074
Endowment and other investment income	1,622,500	1,423,059	1,711,000	1,690,803
Net realized and unrealized gains on investments	-	8,401	-	5,659
Rental income	355,000	357,276	355,000	358,356
Other revenues	10,000	411,719	10,000	116,242
Net assets released from restrictions	689,256	1,065,414	458,986	712,492
Total revenues	<u>\$ 16,076,756</u>	<u>\$ 16,854,519</u>	<u>\$ 15,284,986</u>	<u>\$ 16,817,626</u>
Operating Expenditures:				
Subsidies by Secretariat on Cathedral Square:				
Chancery (Schedule 1)	\$ 1,662,080	\$ 1,599,630	\$ 1,603,348	\$ 1,605,801
Clergy and religious (Schedule 2)	1,399,465	1,155,306	1,349,596	1,139,584
Education (Schedule 3)	1,934,457	2,712,457	1,685,575	1,685,574
Catechetical services (Schedule 4)	875,429	875,429	860,321	860,321
Finance (Schedule 5)	1,314,074	1,171,183	1,074,606	1,144,482
Legal	480,408	446,716	545,768	520,698
Parish life (Schedule 6)	1,092,945	1,029,924	1,057,174	1,020,161
Bishop's direct reporting offices (Schedule 7)	3,799,468	3,772,871	3,758,122	3,747,899
Catholic Community Foundation	778,614	778,614	670,000	670,000
Other expenses:				
Administrative	1,170,070	1,088,701	1,354,500	1,428,910
Pastoral	724,083	612,467	700,562	620,352
Real estate taxes	30,000	31,079	32,000	28,565
Distributions	814,256	736,316	583,986	690,170
Total operating expenditures	<u>\$ 16,075,349</u>	<u>\$ 16,010,693</u>	<u>\$ 15,275,558</u>	<u>\$ 15,162,517</u>
Diocesan consolidation costs	<u>\$ 1,400,000</u>	<u>\$ 1,344,575</u>	<u>\$ 1,032,326</u>	<u>\$ 762,593</u>

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

DETAIL OF UNRESTRICTED REVENUES AND SUBSIDIES BY
SECRETARIAT ON CATHEDRAL SQUARE (CONTINUED)

Years Ended June 30, 2011 and 2010

	2011 Budget	2011	2010 Budget	2010
Schedule 1 - Chancery:				
Cathedral of Saint John the Evangelist	\$ 470,640	\$ 470,640	\$ 487,200	\$ 487,200
Chancery Office	559,464	514,441	486,651	545,039
Communications Department	336,896	315,129	324,095	282,010
Office of Mediation	-	16,082	11,711	10,980
Pastoral Planning	295,080	283,338	293,691	280,572
Total	<u>\$1,662,080</u>	<u>\$1,599,630</u>	<u>\$1,603,348</u>	<u>\$1,605,801</u>
Schedule 2 - Clergy and Religious:				
Clergy Personnel Board	\$ 128,643	\$ 122,383	\$ 124,479	\$ 118,972
Continuing Education and Formation of Priests	140,355	134,063	135,774	129,339
Education of Priests	97,807	88,023	92,881	84,259
Office for Religious	68,991	59,151	75,075	50,069
Pastoral Care of Priests	436,753	317,105	429,836	300,475
Permanent Diaconate	159,461	135,491	190,021	182,916
Secretary for Clergy and Religious	187,449	175,180	184,755	168,372
Senior Priests	78,231	33,429	15,000	15,000
Vocation Office	101,775	90,481	101,775	90,182
Total	<u>\$1,399,465</u>	<u>\$1,155,306</u>	<u>\$1,349,596</u>	<u>\$1,139,584</u>

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

DETAIL OF UNRESTRICTED REVENUES AND SUBSIDIES BY
SECRETARIAT ON CATHEDRAL SQUARE (CONTINUED)

Years Ended June 30, 2011 and 2010

	<u>2011 Budget</u>	<u>2011</u>	<u>2010 Budget</u>	<u>2010</u>
Schedule 3 - Education:				
Office for Catholic Education	\$ 1,322,457	\$ 1,322,457	\$ 1,185,633	\$ 1,185,633
Grade School subsidies:				
Archbishop Lyke Elementary	70,000	70,000	70,000	70,000
Metro Catholic School, Cleveland	50,000	50,000	50,000	50,000
Capital subsidy - Grade and High School	375,000	375,000	262,942	262,941
High School subsidies:				
Operating expenses	<u>117,000</u>	<u>895,000</u>	<u>117,000</u>	<u>117,000</u>
Total	<u>\$ 1,934,457</u>	<u>\$ 2,712,457</u>	<u>\$ 1,685,575</u>	<u>\$ 1,685,574</u>
Schedule 4 - Catechetical Services:				
Newman Campus	\$ 489,407	\$ 489,407	\$ 475,654	\$ 475,654
Religious Education	<u>386,022</u>	<u>386,022</u>	<u>384,667</u>	<u>384,667</u>
Total	<u>\$ 875,429</u>	<u>\$ 875,429</u>	<u>\$ 860,321</u>	<u>\$ 860,321</u>
Schedule 5 - Finance:				
Finance Office	\$ 638,017	\$ 628,526	\$ 609,057	\$ 603,701
Human Resources	165,496	158,901	174,833	160,885
Facilities Services	258,528	265,512	290,716	353,951
Printing and Mailing	-	26,050	-	25,945
Technology Services	200,000	41,886	-	-
Telecommunications	<u>52,033</u>	<u>50,308</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 1,314,074</u>	<u>\$ 1,171,183</u>	<u>\$ 1,074,606</u>	<u>\$ 1,144,482</u>

FINANCE OFFICE OF THE DIOCESE OF CLEVELAND

DETAIL OF UNRESTRICTED REVENUES AND SUBSIDIES BY
SECRETARIAT ON CATHEDRAL SQUARE (CONTINUED)

Years Ended June 30, 2011 and 2010

	2011 Budget	2011	2010 Budget	2010
Schedule 6 - Parish Life:				
Evangelization Office	\$ 109,181	\$ 100,708	\$ 106,445	\$ 102,469
Hispanic Ministry	177,247	147,800	173,708	153,493
Interfaith	21,897	21,684	22,295	21,953
Women in Church and Society	72,317	69,456	67,857	64,717
Pastoral Ministry	221,187	214,181	212,866	210,004
Vietnamese-American Ministry	14,000	14,000	14,000	14,000
Secretary for Parish Life	230,857	214,165	217,600	213,718
Virtus Program	143,682	141,443	144,200	143,655
African American Catholic Ministry	102,577	106,487	98,203	96,152
Total	<u>\$1,092,945</u>	<u>\$1,029,924</u>	<u>\$1,057,174</u>	<u>\$1,020,161</u>
Schedule 7 - Bishop's Direct Reporting Offices				
Office for Worship	\$ 198,632	\$ 182,035	\$ 185,509	\$ 176,156
Saint Mary Seminary	1,698,036	1,688,036	1,643,909	1,643,909
Borromeo Seminary	884,083	884,083	825,057	825,057
Center for Pastoral Leadership	501,630	501,630	624,809	624,809
Tribunal	517,087	517,087	447,268	447,268
Stewardship Office	-	-	31,570	30,700
	<u>\$3,799,468</u>	<u>\$3,772,871</u>	<u>\$3,758,122</u>	<u>\$3,747,899</u>